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In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. <u>96-262</u>
	)	
Price Cap Performance Review	)	CC Docket No. 94-1
for Local Exchange Carriers	)	
	)	
Transport Rate Structure	)	CC Docket No. 91-213
and Pricing	)	

**COMMENTS OF CINCINNATI BELL TELEPHONE COMPANY**

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Dated: January 29, 1997

## SUMMARY

CBT fully supports the Commission's decision to initiate this proceeding. However, CBT submit that delaying access reform for non-price cap LECs will negatively impact those small to mid-size LECs that face the same immediate competitive pressures as the larger price cap LECs.

As a mid-size local exchange carrier (LEC) subject to Optional Incentive Regulation (OIR), CBT faces unique circumstances. For example, CBT operates in a single metropolitan area. Thus, CBT's network is not as geographically expansive as the networks of the larger price cap LECs. As a result, unlike the large price cap LECs, CBT is not in a position to generate significant new revenue streams from entry into the in-region interLATA interexchange business. CBT also lacks the financial resources of the larger price cap LECs and, thus, does not have the ability to make the major investments necessary to develop other new lines of business (e.g., equipment manufacturing, overseas ventures, etc.).

In addition to these unique circumstances, CBT faces the same competitive pressures as the price cap LECs. Thus, while CBT does not advocate a one-size-fits-all approach to access reform, CBT submits that the Commission must not delay access reform for non-price cap LECs. Accordingly, the Commission should immediately begin the process of reforming the access charge system for non-price cap LECs.

CBT's comments address the proposals in the NPRM that apply to all LECs. However, CBT also addresses other proposals in the NPRM that it believes are equally relevant to non-price cap companies. Finally, CBT offers suggestions as to how the OIR rules should be changed to allow OIR carriers to compete effectively in the market for access services.

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	)	

**COMMENTS OF CINCINNATI BELL TELEPHONE COMPANY**

**I. INTRODUCTION**

CBT, an independent, mid-size incumbent local exchange carrier, submits these comments in response to the Commission's December 24, 1996 Notice of Proposed Rulemaking ("NPRM") in the above-captioned proceeding. In this proceeding, the Commission seeks comments on how to change its system of access charge rules "to make it more compatible with the competitive paradigm established by the 1996 Act and with state actions to open local networks to competition."<sup>1</sup>

There is clearly a need for comprehensive access charge reform in today's competitive telecommunications market. While the current system of support flows worked as long as LECs were monopoly providers of local exchange and exchange access services, it is not sustainable

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<sup>1</sup> NPRM para.1.

in the competitive market envisioned by the 1996 Act. Thus, CBT fully supports the Commission's decision to initiate this proceeding.

The need for access reform is common to all LECs, large and small, and without regard to a LEC's regulatory status. While CBT does not advocate a one-size-fits-all approach to access reform, CBT does submit that delaying access reform for non-price cap LECs will negatively impact those small to mid-size LECs that face the same immediate competitive pressures as the larger price cap LECs. Thus, CBT strongly disagrees with the Commission's decision to delay access reform for non-price cap LECs.

The Commission has indicated its intent to limit the scope of this proceeding, with a few exceptions,<sup>2</sup> to changes in the access charge system applicable only to price cap carriers. As a carrier subject to Optional Incentive Regulation (OIR),<sup>3</sup> CBT's comments address the proposals that would apply to all LECs. However, these comments also address several other proposals in the NPRM that CBT believes are equally relevant to non-price cap companies. CBT also offers suggestions as to how the OIR rules should be changed to allow OIR carriers to compete effectively in the market for access services.

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<sup>2</sup> The exceptions are proposals related to the allocation of universal service support to the interstate revenue requirement, revisions to the transport rate structure, including the TIC, possible changes to the common line rate structure, and a few proposed updates to the Part 69 rules to reflect various developments.

<sup>3</sup> CBT is subject to Optional Incentive Regulation for interstate access services under section 61.50 of the Commission's rules. The OIR rules became effective on June 11, 1993. *See*, Report and Order, CC Docket No. 92-135, *adopted* May 13, 1993, *effective* June 11, 1993. CBT's initial tariff filing under the OIR regulations was made on October 1, 1993, with an effective date of January 15, 1994.

## **II. COMPREHENSIVE ACCESS CHARGE REFORM FOR NON-PRICE CAP INCUMBENT LOCAL EXCHANGE CARRIERS CANNOT BE DELAYED**

In the NPRM, the Commission concluded that the need for access reform for non-price cap LECs is not as immediate as for price cap LECs. CBT strongly disagrees with that conclusion. CBT faces the same competitive pressures as the price cap LECs. Moreover, CBT faces additional business risks due to its smaller size and scope.

CBT has had competition in the market for special access services for several years. There are currently six competitive access providers<sup>4</sup> operating or with plans to begin operating in CBT's territory.<sup>5</sup> These providers have targeted major business customers in the Cincinnati metropolitan area. CBT has already lost market share to some of these competitors and just earlier this month one of CBT's major access customers notified CBT that it would be moving a large number of its DS3s to a competitive access provider over the next several months. This move alone reflects a loss of approximately 12% of CBT's DS3s. Clearly, CBT, a non-price cap incumbent LEC, is facing real competition in the market for special access services.

On the local competition front, CBT currently has requests for interconnection from seven carriers. These companies have requested unbundled loops, transport and termination, and resale. At least four of the seven already have or plan to locate switches in CBT's territory. In addition, seven other carriers have petitioned the Public Utilities Commission of Ohio (PUCO) for

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<sup>4</sup> These providers include Time Warner AxS, MCI/MCI Metro, Intermedia Communications, ICG Access Services, Teleport Communications Group, and Cable & Wireless.

<sup>5</sup> CBT operates in four counties in southwestern Ohio, six counties in northern Kentucky, and two counties in southeastern Indiana. All but one of these counties (i.e., Butler County, Ohio) are within the Cincinnati MSA.

certification to provide local exchange service in Ohio, but have not yet entered into interconnection negotiations with CBT.

CBT submits that the non-price cap incumbent LECs facing the competition described above need access reform just as much as, if not more than, the price cap carriers. Because non-price cap carriers are generally smaller, and often operate in a single geographic market, the loss of one major customer to a competitor could have severe consequences for the incumbent LEC if it does not have the flexibility to respond as dictated by a competitive market.<sup>6</sup> In addition, non-price cap LECs are generally not in a position to exploit the benefits conferred upon incumbent LECs as a result of the 1996 Act. For example, unlike the large price cap LECs, non-price cap LECs' networks generally are not as expansive as the large LEC networks which span many states. As a result, these small and mid-size LECs cannot generate significant new revenue streams from entry into the in-region interLATA interexchange business, nor do they have the resources to enter video markets, equipment manufacturing, or overseas ventures. Thus, in many ways, the 1996 Act imposes significant new burdens on non-price cap LECs, with no corresponding benefits. In short, delaying access reform for non-price cap LECs may seriously jeopardize the ability of certain small to mid-size incumbent LECs to remain viable competitors.

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<sup>6</sup> Although the loss of a major customer is significant for any LEC, as a general matter the impact on non-price cap LECs is likely to be more severe. Non-price cap LECs tend to operate in smaller geographic areas. Indeed, in some cases the territories of non-price cap LECs are confined to a single metropolitan area. Thus, as competitors enter the markets served by these non-price cap LECs, the loss of even a single major customer will have a very significant impact. Price cap LECs on the other hand generally operate in larger geographic areas, often encompassing several states. Therefore, for price cap LECs the loss of one customer will be tempered by other areas which may not be subject to the same level of competition.



Accordingly, CBT submits that the Commission must address access reform for non-price cap LECs immediately.

### **III. RATE STRUCTURE MODIFICATION**

Section III of the NPRM explores a number of rate structure modifications for switched access service. With the exception of the revisions considered for transport rules and the transport interconnection charge (TIC), the Commission proposes applying any such changes only to price cap carriers.<sup>7</sup> CBT submits that any changes which lead to a more efficient rate structure should be equally applicable to non-price cap LECs. Currently all LECs are subject to the same rate structure. As the Commission observes in several places throughout the NPRM, the current “rate structure rules do not send accurate pricing signals to customers, and consequently, encourage inefficient use of telecommunications services.”<sup>8</sup> Although the Commission is correct that the existing rate structure might be sustainable in a monopoly environment,<sup>9</sup> that is not a sufficient reason to delay changing it for non-price cap LECs.

#### **A. Common Line**

CBT agrees that the common line rate structure needs to be modified to more accurately reflect the manner in which costs are incurred. CBT’s suggestions relative to the Subscriber Line Charge (SLC) and Carrier Common Line Charge (CCLC) are discussed below.

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<sup>7</sup> NPRM para. 56.

<sup>8</sup> NPRM para. 8, 17 and 55.

<sup>9</sup> NPRM para. 8.

## **1. Subscriber Line Charge**

An important step in moving access rates to levels sustainable in a competitive market is the elimination of the SLC cap concurrent with elimination of the CCLC.<sup>10</sup> In conjunction with removing the SLC cap, CBT recommends that carriers should have the flexibility to deaverage the SLC based on geographic zones. Having the flexibility to price closer to cost for a geographical area would allow appropriate economic signals to be sent to the marketplace. However, CBT opposes any proposal to deaverage the SLC if the residential and single line business cap stays at \$3.50 as proposed in the NPRM.<sup>11</sup> Continuing the SLC cap at \$3.50 under these circumstances for residential and single line business customers would defeat the purpose of deaveraging. This artificial cap would continue to require the retention of a CCL element which would be charged to IXCs, rather than the cost causers, thereby continuing the subsidization which the Commission seeks to eliminate through this access reform proceeding. The CCL exists today because the SLC cap is too low. Allowing LECs to reduce SLCs in some areas while retaining the \$3.50 overall cap would only cause the residual (CCL subsidy requirement) to grow larger. The resulting increase in the CCLC would be contrary to the efficient competitive marketplace in which prices should be reflective of the manner in which costs are incurred.

The Commission proposes to increase the SLC cap for second and additional lines for residential customers and for all lines for multi-line business customers.<sup>12</sup> Although this would

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<sup>10</sup> Unfortunately the Universal Service Joint Board recommended against increasing the SLC cap. See, Joint Board Recommended Decision para. 754.

<sup>11</sup> NPRM paras. 64 and 67.

<sup>12</sup> NPRM para. 65.

allow carriers to recover costs for these lines directly from the cost causer, CBT submits that without the ability to do the same for primary residential lines and single line business lines, such a change would provide incorrect signals to consumers and distort the rational workings of a competitive market. This result would follow since consumers do not understand the complex system of subsidies in the current rate structure that keeps their residential rates low. As a result, they will not understand why the rate for a second line is higher than the rate for their primary line. Consequently, customers will be more likely to purchase their second or additional lines from a competitive provider who is not subject to the myriad of regulations which force incumbent LECs to price their services in an inefficient manner. Thus, until the cap is removed for primary residential lines and single line business lines, it should not be increased for second lines or multi-line business lines.

In addition, the administrative difficulties and potential for fraud mitigate against raising the cap for additional residential access lines. Because additional access lines are often put in the name of an individual other than the subscriber to the first line, it would be difficult for LECs to track additional lines with any degree of accuracy. Very explicit rules would be required for purposes of determining which lines would be considered additional lines. If a line is only considered a second line if it is in the same name as the first line, customers would have an incentive to put the second line in another name. On the other hand, classifying all but one line to the same residence as additional lines would have inequitable consequences, particularly for unrelated individuals who share the same residence.

Trying to assess higher charges on lines other than those running to a primary residence also raises administrative and equity concerns. It would be very difficult for a carrier to ascertain

whether two listings in the same name but at different locations were actually purchased by the same person. Even if this hurdle could be overcome, the LEC would still have to determine which residence qualifies for the lower SLC. In any event, customers could easily avoid the higher SLC by simply listing the lines under different names.

## **2. SLCs on Derived Channels**

The Commission asks for comment on how many SLCs should be applied to Integrated Services Digital Network (ISDN) and other derived channel services.<sup>13</sup> CBT supports the position of assessing one SLC charge on each local loop used to provide ISDN services.<sup>14</sup> CBT submits that this per-facility approach is the most appropriate method for assessing the SLC charge. The per-facility approach recognizes that the costs incurred by LECs to provide ISDN and other derived channel services are not dependent on the number of channels and, thus, would allow LECs to price these services closer to their true economic cost.

CBT realizes that a drawback of this approach is that it could result in lower SLC revenues, and correspondingly place upward pressure on CCL rates. With the current cap in place, as customers migrate to derived channel services, such as ISDN, which make it possible to replace existing services using multi-network terminations with a single loop, SLCs will recover proportionately less of the non-traffic sensitive costs of the loop. Under present Commission rules, this will lead to higher CCL rates. However, in conjunction with an increase or elimination of the SLC cap as recommended above, this problem could be avoided. CBT

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<sup>13</sup> NPRM para. 70.

<sup>14</sup> This position is consistent with CBT's comments in CC Docket No. 95-72, copies of which are attached to these comments.

believes that its recommended approach would properly recover the costs from the cost causers and encourage the use of derived channel technologies.

### **3. Carrier Common Line Charge**

CBT agrees with the Joint Board that the current, traffic sensitive CCLC structure is economically inefficient.<sup>15</sup> As stated above, CBT believes that a properly designed rate structure that sends the proper economic signals in a competitive market requires that the full amount of common line costs be recovered from end users through the SLC.

If CBT's preferred approach is not allowed, CBT supports the recovery of the costs not recovered from the SLC via a flat, per-line charge paid by IXC's as recommended by the Joint Board. However, because of the administrative difficulties involved when customers switch from PIC to no-PIC status and vice versa, CBT does not support collecting the flat-rate charge directly from end-users who do not choose a PIC. Not only must a LEC adjust the end user's bill, but also the PICed carrier's bill. This would be further complicated by the need to prorate charges for both the end user and the IXC when a customer selects (or leaves) an IXC in the middle of a billing cycle. Furthermore, as mentioned in the NPRM,<sup>16</sup> the Joint Board has recommended that the SLC cap for residential and single line business not be increased. Since billing the recommended per-line charge directly to end users is essentially equivalent to increasing the SLC for these end users, CBT submits that such a recovery mechanism for non-PICed lines would contradict the Joint Board's intent of not increasing the SLC on residential and single line businesses. CBT believes that an administratively simpler approach that is more consistent with

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<sup>15</sup> NPRM para. 59.

<sup>16</sup> NPRM para. 64.

the Joint Board's position on the SLC would be to bill the IXC's for non-PIC lines based on their share of PIC lines.

#### **B. Local Switching & Transport**

Rigid rate structures have no place in a competitive market. Thus, rather than mandating a specific structure for all carriers, CBT recommends that the Commission allow the carriers the flexibility to determine the appropriate structure for their switching and transport services. A flexible structure will allow LECs to set rates to most accurately reflect the manner in which costs are incurred using each LEC's technology and network configurations.

#### **C. Transport Interconnection Charge (TIC)**

As the Commission observes in the NPRM, the TIC is a charge created by regulators to achieve a variety of public policy goals such as reducing the impact of tandem switching rates on small IXC's.<sup>17</sup> Although the TIC as we know it today was established in the interim transport rate structure order resulting from CC Docket No. 91-213, many of the policy decisions that are the basis of the components of the TIC span several decades.<sup>18</sup>

The costs assigned to the TIC are legitimate LEC costs which LECs must be allowed to fully recover. While regulators and telecommunications carriers today may question the wisdom of the policy decisions made by regulators in the past, that does not change the fact that the costs

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<sup>17</sup> NPRM para. 96.

<sup>18</sup> CBT will not elaborate on the policy decisions that created the misallocations that currently exist in the TIC. See USTA's comments in this proceeding for a thorough discussion on this topic.

LECs currently recover through the TIC are legitimate. The costs currently recovered through the TIC are the result of LECs applying the Part 36 and Part 69 rules as directed by the Commission. Because the costs currently recovered through the TIC are legitimate costs which the LEC must be permitted to recover, there can be no phase-out of the TIC without concurrent separations reform or the establishment of an alternative recovery mechanism that enables LECs to recover these costs in a more appropriate manner.

As the Commission indicates in the NPRM, there are various explanations for the costs included in the TIC.<sup>19</sup> Some costs are clearly due to transport rate setting choices made by regulators while others are due to cost misallocations. As discussed more thoroughly in USTA's comments, a significant portion of the TIC costs are undoubtedly due to jurisdictional misallocations that will require a Federal-State Joint Board to correct. Therefore, the entirety of the TIC cannot be addressed in this proceeding. By changing only the access rules, a shortfall will be created for those costs which cannot be economically attributed to another access element (e.g., Local Switching, Special Access, etc.). Without a joint board decision these costs cannot be reassigned to the appropriate interstate services.

The Commission puts forth four methods for revising the TIC,<sup>20</sup> three of which involve phasing out the TIC. The Commission offers no reasonable justification for a phase-out of the TIC. The phase-out is suggested solely because as the Commission says, "it is administratively simpler, and it is likely that we could not establish the causes for all the costs included in the

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<sup>19</sup> NPRM para. 101.

<sup>20</sup> NPRM paras. 112-122.

TIC.”<sup>21</sup> CBT asserts that administrative simplicity is not a sufficient justification for denying LECs the opportunity to recover validly incurred costs.

CBT submits that the Commission’s second alternative is the proper way to address the TIC.<sup>22</sup> Under this approach, all costs in the TIC would be quantified and all misallocations would be corrected. CBT recommends that the Commission should reassign the readily identifiable service related costs to the correct rate elements, and allow LECs to recover the remaining costs (which are due to separations and regulatory policy decisions and cannot be addressed without Federal-State Joint Board action) from purchasers of switched access via a MOU charge until both separations reform and access reform is completed.

CBT believes that all LECs should be permitted to recover the remaining costs. However, it is particularly imperative to allow non-price cap LECs to continue to recover these costs since their rates were and still are developed based on rate base, rate of return (revenue requirement) methods.

#### **IV. MARKET-BASED APPROACH TO ACCESS REFORM AND DEREGULATION IS THE PROPER APPROACH**

In sections IV, V, and VI of the NPRM the Commission describes two approaches for reforming and deregulating access services for price cap LECs and the advantages and disadvantages of each approach. CBT believes that a market-based approach is the only appropriate way to transition incumbent LEC access services to a deregulatory environment. The

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<sup>21</sup> NPRM para. 117.

<sup>22</sup> NPRM para. 116.



Commission's concern is that access rates move towards cost. In a market free of regulatory constraints, prices will move to efficient levels. If the Commission removes the rigid rules which prohibit LECs from responding to market pressures simultaneously with the development of competition for those services, the market will determine the appropriate prices. As long as competitors are free to enter the market, LECs will be unable to charge excessive prices. If prices are too high, competitors will enter and drive the price down. With the availability of unbundled elements and resale as mandated by the 1996 Act and the Interconnection Order, competitors can readily enter the market. Thus, CBT submits that the Commission need not worry that prices will not drop rapidly enough.

The primary advantage the Commission cites for using a prescriptive approach is to bring prices down faster than the market would dictate.<sup>23</sup> That alone should be sufficient reason to avoid a prescriptive approach. If the Commission prescribes the outcomes for a segment of the market and tries to move prices down faster than the market would naturally take them, then we do not have a competitive market. In that case, the Commission would be deciding the winners and losers in the market. As evidenced by the pricing debates in the Interconnection Order and the cost proxy models, setting prices is not an easy task. CBT suggests that it would be impossible for the Commission to accurately set prices for all services for all LECs. The amount of regulation and resources that would be required to implement such a system would be tremendous and would be contrary to the deregulatory environment envisioned by the 1996 Act. Regardless of how much time and effort the Commission devoted to such a system, it could not do a better job than the market itself.

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<sup>23</sup> NPRM para. 143.

CBT believes that the market-based approach can be applied on a service-by-service basis and by geographical area for any LEC which satisfies the appropriate competitive criteria. In short, non-price cap LECs that have competition for their services must be accorded relief from the rigid access charge rules. CBT is not suggesting that all carriers be subject to the same rules, but that the rules for each form of regulation that exist today be modified to provide the LEC the flexibility to effectively compete. Thus, as a company subject to OIR regulation, CBT herein suggests the appropriate changes to the OIR rules to give it the flexibilities it needs to effectively compete in the access market.

Carriers subject to OIR under section 61.50 of the Commission's rules use the same baskets and service categories as prescribed for price cap carriers under section 61.42(d) and (e). Therefore, CBT submits that upon the appropriate competitive showing, OIR carriers be accorded the same changes to the basket structure as the price cap carriers. Furthermore, additional flexibilities such as term and volume discounts, contract pricing, deregulation of new services, deaveraging by class of customer and elimination of the rigid Part 69 rate structure are equally appropriate for OIR carriers facing competition.

#### **A. Determinants of Substantial Competition**

The Commission proposes several factors for determining if substantial competition is present in a market.<sup>24</sup> CBT believes that complex measures of demand and supply responsiveness are not necessary to determine if competition exists. CBT asserts that evidence that comparable

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<sup>24</sup> The factors the Commission proposes are demand responsiveness, supply responsiveness, market share, pricing behavior under price caps. NPRM paras. 156-160.

access services are available from other carriers is the appropriate factor to consider in lieu of a specific measure of demand elasticity. Likewise, CBT believes that the availability of unbundled elements makes a measure of supply elasticity unnecessary.

The Commission's third factor is market share. Although the Commission indicates that "high market share does not necessarily confer market power",<sup>25</sup> it does propose that market share data should be considered when determining the level of competition. CBT cautions against using market share measures, particularly in the access market where only a few customers account for a significant portion of the market. The loss of one customer can have devastating impact on a carrier. This is especially true for smaller carriers, particularly carriers operating in single geographic markets. In such cases, their market share can drop considerably in a very short period of time. Market share loss will not be a gradual process as it was with AT&T in the long distance market, which was not subject to large swings due to the movement of a few customers. Market share is also an inappropriate measure in regulated industries like telecommunications where the market share has been created by regulatory actions.

**B. Services Currently Subject to Substantial Competition Should be Deregulated Now**

In the NPRM,<sup>26</sup> the Commission asks whether certain services such as directory assistance and special access services could be deregulated immediately. CBT believes that the Commission should immediately forbear from regulating directory assistance for all LECs. Directory

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<sup>25</sup> NPRM para. 158.

<sup>26</sup> NPRM paras. 151 and 153.

assistance has changed dramatically in recent years. Directory assistance is now available on CD ROM, through Internet databases, and other electronic listings. There are also a variety of independent operator service providers and outsourcers such as Excell, InfoNXX, and MetroMail which are gaining significant volumes of directory assistance traffic. CBT has already lost one of the largest volume directory assistance customers to one of these operator service providers. CBT notes that these competitive directory assistance services developed before the enactment of the 1996 Act. Now that CLECs and IXC's are authorized to enter the traditional dial-up market, the level of competition will increase rapidly. The new local service provider may provision directory assistance internally or route their traffic to any service provider in the country including OSPs, RBOCs and other LECs. For example, Time Warner has contracted with Rochester Telephone to handle its directory assistance traffic while Hart Communications routes a portion of its local DA calls to a directory assistance provider in Texas. Because the aforementioned directory assistance services are available virtually nationwide, CBT asserts that no company-specific showing of substantial competition is necessary for directory assistance. Directory assistance should be deregulated immediately for all LECs regardless of the form of regulation (i.e., price caps, OIR, or rate-of-return).

Likewise, the Commission should immediately deregulate special access services in all areas and direct trunked transport in areas where collocation is available. Competitive access providers (CAPs) have been operating in LEC markets, particularly the major metropolitan markets, for a number of years. CAPs have been in CBT's market at least since 1991. Since CAPs do not require the use of LEC facilities to provide their service no argument can even be made that LECs can keep competitors out of their market by controlling bottleneck facilities.

With the availability of unbundled elements and both physical and virtual collocation, it has become even easier for CAPs and IXC's to provide substitutes to LEC special access and direct trunked transport. Furthermore, special access and direct trunked transport customers (IXCs and large businesses) are very sophisticated and will shop for the best deal available whether or not LEC rates are tariffed. LECs simply have no ability to control prices for these services. CBT submits that the continuation of tariffing requirements for these access services is no longer necessary. The alternative providers of special access and direct trunked transport are virtually void of any regulation. Incumbent LECs should be subject to the same regulatory treatment. These services must be deregulated immediately for non-price cap LECs as well as for price cap LECs. The loss of one large special access or direct trunked transport customer can have a significant impact, particularly on a relatively small LECs like CBT.<sup>27</sup> CBT is not asking the Commission to give it an advantage over its competitors, but merely to enable it to compete according to the same rules.

**C. Pricing Flexibility and Deregulation of Other LEC Access Services for Non-Price Cap LECs**

Under the Commission's proposed market-based approach, price cap LECs would be granted additional pricing flexibility and certain regulatory burdens would be lifted in phases corresponding to potential, actual, and substantial competition. CBT recommends that the Commission apply the following market-based reforms to all non-price cap LECs upon the proper

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<sup>27</sup> For example, as previously noted in these comments, recent actions by one of CBT's access customers will result in a loss of 12% of CBT's DS3s to a competitive access provider.

competitive showing. As CBT indicates above, certain services such as directory assistance and special access should be deregulated immediately for all carriers, regardless of whether they are likely to face competition for local exchange services or not. For other access services, however, CBT believes that a company specific showing is proper. However, CBT submits that non-price cap LECs, because of their smaller size and limited geographic scope, should be subject to two phases (Phase 1--Potential Competition and Phase 2--Actual Competition) rather than the three phases suggested by the Commission.<sup>28</sup>

The phases should be tied to the removal of barriers to entry, the availability of alternative sources of supply, and ease with which customers can avail themselves of the offering of a competitor. Once a LEC enters into an interconnection agreement that provides for unbundled elements, transport and termination, and resale, there is no doubt that barriers to entry have been removed. Competitors entering the market can provision the service themselves, purchase unbundled elements, or resell the incumbent LEC's service. Regardless of the method the new entrant uses to provide services, customers will have a choice of providers and will be able to easily move from one to the other.

Thus, once an interconnection agreement is in place, CBT believes that regulatory relief is appropriate. Non-price cap LECs would be able to deaverage prices by geographic areas and by class of customer, offer term and volume discounts and contract tariffs, respond to RFPs, and to introduce new services free from regulatory constraints. Since OIR companies use the same basket structure as the price cap carriers CBT submits that OIR companies would move to the

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<sup>28</sup> CBT suggests that the two phase approach may be equally applicable to smaller price cap carriers.

same simplified basket structure as the price cap LECs. As such, CBT supports the simplified basket structure proposed by USTA in its comments. There would be a network services basket with four categories: 1) tandem switching and transport, 2) local switching, 3) data base services, and 4) common line. In addition, CBT recommends that the rigid Part 69 rate structure be eliminated in Phase 1. For non-price cap LECs, CBT recommends that the Part 69 switched access rules be amended to reflect one access revenue requirement. This would lift the constraints that currently prevent non-price cap LECs from responding to the needs of their customers' needs. This flexibility will be imperative when competing against new entrants who will be entering the market with the ability to package their services in any way they want to satisfy their customers. If the non-price cap LECs must wait until they actually have competitors operating in their market before being granted this flexibility, it may arrive too late to do them any good. They must be on equal footing with the new entrant from the beginning.

CBT believes that the deregulation of new service offerings at this phase is particularly important and should be available to all carriers. CBT is particularly concerned that the Commission in the Third Report and Order in CC Docket No. 94-1 significantly streamlined the rules for new service introduction for price cap LECs, but has not yet addressed this issue for non-price cap LECs. The Commission must realize that the waiver process affects all LECs and their customers equally. Special treatment should not be afforded solely to LECs operating under price cap regulation. As the Commission observes, easing the rules for new service introduction "could increase customer choice, streamline regulation, and increase consumer welfare by increasing incentives for innovation."<sup>29</sup> There is nothing unique about price cap carriers, that

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<sup>29</sup> NPRM para. 197.

makes this statement applicable only to their service offerings and their customers. The same benefits will be realized by customers of non-price cap LECs. By continuing to require non-price cap LECs to seek waivers before introducing new services, the Commission appears to be going out of its way to disadvantage these small and mid-size LECs and their customers. Thus, CBT submits that the Commission should immediately eliminate the waiver process for all non-price cap LECs and deregulate all new services completely as soon as a non-price cap LEC has an interconnection agreement in place.

Phase 2 would be triggered by the actual presence of a competitor in the non-price cap LEC's territory. At this point CBT recommends that the Commission forbear from regulating the non-price cap LEC on a service-by-service basis. Since these LECs are small and mid-size carriers, this should apply to LEC's entire territory within a LATA as soon as a competitor is present in the territory. CBT submits that no additional showing is necessary for these small and mid-size LECs. Once the barriers to entry have been removed as evidenced by the existence of an interconnection agreement, these smaller carriers clearly cannot exert market power against the telecommunications giants that will be their competitors. If these small and mid-size LECs are forced to show losses to competitors before being deregulated, the Phase 2 flexibilities may well come too late. These small and mid-size carriers must at least be given a chance to compete against these large national and international telecommunications providers on equal terms. The public interest will not be served if asymmetric regulations drive the existing LEC from the market only to be replaced with a single new entrant. The idea of competition is to enhance consumer welfare by offering customers choices in providers, services, quality, prices, etc. If the existing provider is not given the opportunity to compete against the new entrants, the benefits



of competition will be delayed to consumers in the areas served by these small and mid-size LECs.

## **V. TREATMENT OF REMAINING EMBEDDED COSTS**

During the monopoly era incumbent LECs were required to make significant investments to ensure the development of a ubiquitous Public Switched Telephone Network (PSTN). These investments were made by incumbent LECs with the assurance that they would be given a reasonable opportunity to recover their investments, including a reasonable return thereon, and expenses over time periods dictated by state and federal regulators. Incumbent LECs have a right to be adequately compensated for the embedded costs they have incurred but not yet recovered in the fulfillment of this compact with regulators. An important point which new entrants want the Commission to ignore is that incumbent LEC revenue streams currently include payments to recover the embedded investments (plus a reasonable return thereon), expenses, and taxes incurred in building the PSTN.

A key component of the regulatory compact was that incumbent LECs agreed to allow the regulators to determine the timing of cost recovery by prescribing depreciation rates, prescribing the return on investment, and prescribing the level of expenses and income taxes that would be included in the prices they charged to their customers. In addition, it was also understood, that incumbent LECs would be the only providers of local exchange service within their franchise areas. During this period, one of the major policy objectives of the regulators was to foster universal service (i.e., keeping rates low and affordable for residential customers). The regulators have traditionally furthered this policy objective by prescribing artificially low